JANUARY 2011

The health care battles continued in January, with dueling congressional hearings, a vote in the newly Republican-controlled House in favor of repeal of the reform law and a federal court ruling that the entire law should be struck down. Meanwhile, the Congressional Budget Office forecast trillions of dollars in federal deficits in coming years, the panel created to investigate the causes of the nation's financial crisis released a politically-divided report to little acclaim, and a Nevada lawmaker introduced a non-binding resolution opposing federal bailouts of public pension plans.

ISSUES AND EVENTS

CalPERS Lauds Health Care Reform Law in Statement to Congress

CalPERS in late January submitted a statement for a congressional hearing to express the pension fund's "strong support for the new health care law and to urge its continued timely, efficient implementation."

CalPERS drafted the statement for the House Ways and Means Committee's Jan. 26 hearing on the economic impact of last year's health care reform law at the request of the office of Rep. Pete Stark of California, the ranking Democrat on the Ways and Means Health Subcommittee. The statement is similar to one CalPERS submitted to the U.S. Department of Health and Human Services in December.

"CalPERS has energetically supported key elements of the legislation designed to constrain cost growth, improve quality, and expand coverage to the uninsured," CalPERS stated. "In addition, there are other major aspects that are critically important including: significant investments in comparative effectiveness research; strengthening the Medicare program by realigning payment incentives to reward value over volume of services; providing a landmark investment in prevention and wellness initiatives; developing a national strategy to improve quality measurement and reporting; and offering direct financial assistance to ensure affordability of coverage in combination with an individual requirement to purchase coverage. We believe that these measures, combined with strong insurance reforms, fundamentally alter and improve the way health care is delivered and purchased in this country."

The pension fund highlighted three provisions of the reform law on which it regarded its implementation as "early successes" – the extension of dependent coverage to age 26; the removal of lifetime dollar limits on benefits; and the Early Retiree Reinsurance Program, which it projects will provide savings of $200 million to CalPERS early retirees, their spouses, dependents and survivors.

While Austan Goolsbee, chairman of the Council of Economic Advisors, represented the Obama's administration's position at the hearing, each of the three non-governmental witnesses called by the Republican majority offered negative comments about the law's impact. Douglas Holtz-Eakin, president of the American Action Forum and a former director of the Congressional Budget Office, said that the law's employer mandate costs, administrative burdens and tax increases "will have detrimental impacts on employment growth, wages and economic growth," and added that the law will drive up the cost of health insurance, encouraging employers to drop coverage.

The other two witnesses were business owners, one of whom represented the U.S. Chamber of Commerce, one of the reform law's biggest opponents.

The following day, the Senate Health, Education, Labor and Pensions Committee held a similar hearing. Reflecting the Democratic control of the chamber, the balance of testimony was shifted, with four of the five witnesses praising the effects of the law. One of the witnesses was U.S. Health and Human Services Secretary Kathleen Sebelius, who also last week released a report that concluded that the reform law will save families up to $14,900 a year and will save small businesses as much as $6 billion over two years.

Republicans challenged the report's conclusions, noting that the Congressional Budget Office found in November 2009 that the law, in at least some cases, will raise premiums.

"The agency should consider spending more time on the quality of its scientific analysis and less time trying to talk the American public into supporting a law they have rejected," said House Energy and Commerce Committee Chairman Fred Upton, R-Mich, one of the leaders of the GOP effort to undo the law. "If this is the level of seriousness we see in their analysis of the law, one can only guess what is in store for its implementation."

On Jan. 25, President Obama devoted only a few minutes to health care during his State of the Union Address, a speech that focused primarily on national competitiveness. He offered to work with Republicans to improve the law – such as by eliminating some of the administrative burdens it places on small businesses – but he cautioned against "re-fighting the battles of the last two years." In addition, he acknowledged that meaningful deficit reduction "means further reducing health care costs, including programs like Medicare and Medicaid, which are the single biggest contributor to our long-term deficit." He offered no specifics regarding further reductions but referred to Congressional Budget Office projections that "repealing the health care law would add a quarter of a trillion dollars to our deficit."

House Votes to Repeal Health Care Reform Law

The House of Representatives on Jan. 19 voted to repeal the health care reform law, a mostly symbolic move on a piece of legislation that has essentially no chance of being enacted.

Three Democrats joined all House Republicans in voting 245-189 to undo the reform package.

"The House has acted to begin the important work of replacing the job-destroying health care law with common-sense reforms that lower costs and protect jobs," Speaker of the House John Boehner, R-Ohio, said. "The American people deserve a thorough and forward-looking discussion of the health care law's impact on our economy and how best to replace it with reforms that reflect their priorities."

Boehner referenced a letter sent by 200 economists to House and Senate leaders that called the reform law "a threat to U.S. businesses" that "will place a crushing debt burden on future generations of Americans." Two of the signers are former directors of the Congressional Budget Office, Douglas Holtz-Eakin and June O'Neill.

Obama administration officials, though, rejected those and other claims made by opponents of last year's Patient Protection and Affordable Care Act.

"Repealing the Affordable Care Act would raise health insurance costs for families, add to our federal deficit, put control back in the hands of insurance companies, and take away the freedom and health security being realized by millions of Americans," Health and Human Services (HHS) Secretary Kathleen Sebelius said. "That would be the wrong direction for our country, and would be disastrous for the health and well-being of American families."

Sebelius also noted that an HHS study released on Jan. 18 concluded that as many as 129 million Americans have one or more pre-existing conditions that could cause them to be unable to get coverage without the protections provided by provisions of the reform law.

While many Democrats – including President Obama – have expressed a willingness to work with Republicans to modify the reform law, some have expressed doubts about the sincerity of GOP lawmakers on the health care issue given their previous inaction.

"For 12 years, they had control of the Congress," Rep. Xavier Becerra, D-Calif., noted. "For six years, they had a Republican president to work with."

Senate Majority Leader Harry Reid, D-Nev., has said that he will not bring the repeal bill to a vote in the Senate, but Minority Leader Mitch McConnell, R-Ky., on Jan. 23 reiterated his intention to force a vote.

"I'm not going to discuss how we're going to do it from a parliamentary point of view here, but it's very hard to deny people votes in the Senate, and I assure you we'll have a vote on repeal," McConnell said on "Fox News Sunday."

McConnell could put the bill before the Senate by offering it as an amendment to another piece of legislation. With Democrats controlling 53 seats in the 100-member chamber, though, passage is unlikely, especially since a 60-vote super-majority would almost certainly be needed. And even if the bill made it to Obama's desk, he would be sure to veto it.

It appears likely, though, that Republicans will target the reform law in other ways, such as by trying to eliminate specific provisions and by using the appropriations process to block implementation efforts.

The legal challenge to the law's individual mandate, meanwhile, continues to work its way through the courts on many different tracks that will eventually converge at the U.S. Supreme Court. In Michigan in mid-January, several supporters of the health care law – including Reid and House Minority Leader Nancy Pelosi, D-Calif. – filed briefs in a case before the U.S. Circuit Court of Appeals.

"The amicus brief makes our position clear: the health reform law is constitutional, falls within the bounds of congressional power, and is consistent with longstanding precedents of the Supreme Court," Pelosi said. "By filing this brief, Democratic leaders are taking a strong stand against any and all efforts to repeal patients' rights and put insurance companies back in charge of Americans' health choices."

Attorneys general from California, Iowa, Oregon, New York, Vermont, Hawaii, Maryland, Delaware and Connecticut also submitted briefs supporting the administration on Jan. 21, the last day on which they could be filed.

In October, the Michigan case went before a U.S. District Court judge, who upheld the law's requirement that all Americans have health insurance or pay a penalty.

On Jan. 31, in a separate case brought by attorneys general from 26 states, a federal judge in Florida ruled that the individual mandate is unconstitutional and that the entire reform law should be thrown out as a result. He refused a request from the plaintiffs to block implementation of the law, however. Two judges have now ruled that the government cannot require Americans to buy health insurance, and two have ruled that it can.

Financial Crisis Commission Releases Politically Divided Report

The United States' recent financial crisis was avoidable and resulted from "human action and inaction," the Democratic majority on the panel charged by Congress with investigating the causes of the crisis concluded in a report released on Jan. 27.

The Financial Crisis Inquiry Commission spent about a year holding hearings to try to determine what led to the bursting of the housing bubble, the collapse of major financial firms, an economic recession and other fiscal troubles. The final report – which was only endorsed by the six Democrats on the 10-member panel – cast blame in both the public and private sectors.

"The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the American public," the report stated. "Theirs was a big miss, not a stumble. While the business cycle cannot be repealed, a crisis of this magnitude need not have occurred. To paraphrase Shakespeare, the fault lies not in the stars, but in us."

The report cited several "red flags" leading up to the crisis that were largely ignored, including "an explosion in risky subprime lending and securitization, an unsustainable rise in housing prices, widespread reports of egregious and predatory lending practices, dramatic increases in household mortgage debt, and exponential growth in financial firms' trading activities, unregulated derivatives, and short-term 'repo' lending markets."

The report first identifies failures in government supervision as a contributor to the crisis, noting, for example, that the Federal Reserve could have prevented the build-up of bad mortgages by setting "prudent mortgage-lending standards" and that the Securities and Exchange Commission could have stopped risky practices at big investment firms.

"The sentries were not at their posts, in no small part due to the widely accepted faith in the self-correcting nature of the markets and the ability of financial institutions to effectively police themselves," the report stated.

It went on to cite as additional causes:

- Failures in corporate governance and risk management.
- A combination of excessive borrowing, risky investments and lack of transparency.
- Inconsistent responses by the government that added to uncertainty and panic.
- A systemic breakdown in accountability and ethics.

The report gave special attention to three aspects of the financial system that are thought to have contributed significantly to the financial meltdown: the sharp decline in mortgage-lending standards; the misuse of (unregulated) over-the-counter derivatives, including credit default swaps; and the failures of credit rating agencies to provide accurate assessments of risky investments.

"Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs," said commission Chairman Phil Angelides, the former California State Treasurer. "The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done. If we accept this notion, it will happen again."

The report also included two dissents – one from three Republican members, including commission Vice Chairman Bill Thomas, the former congressman from Bakersfield, and one from Republican Commissioner Peter Wallison, a fellow at the American Enterprise Institute. The main Republican dissent built on a report released by the four GOP commissioners in December that pinned much of the blame on the federal government, citing several ways in which they said it had "pushed investors toward investing in mortgage debt." The dissent identified 10 "essential causes" of the crisis, including the credit bubble, the housing bubble and nontraditional mortgages. Wallison, meanwhile, stuck closer to the tone of the December GOP report in stating that "the *sine qua non* of the financial crisis was U.S. government housing policy, which led to the creation of 27 million subprime and other risky loans – half of all mortgages in the United States – which were ready to default as soon as the massive 1997-2007 housing bubble began to deflate."

While some had hoped that the panel would provide a definitive review of the crisis – similar to what the Pecora Commission did following the 1929 stock market crash – reviewers generally seemed unimpressed with the politically divided panel's product.

"These documents resemble not an investigative trilogy but a left-leaning essay collection, a right-leaning PowerPoint presentation and a colorful far-right magazine," Frank Partnoy, a law professor at the University of San Diego, wrote in The New York Times on Jan. 29. "And the confusion only continued during a press conference on Thursday in which the commissioners had little to show and nothing to tell."

CBO Forecasts Massive Deficits

The head of the Congressional Budget Office (CBO) painted a dismal budget picture for Congress in late January.

At a Senate Budget Committee hearing on Jan. 27, CBO Director Douglas Elmendorf recapped the findings of a report that that projects a $1.5 trillion deficit – 9.8 percent of GDP – for fiscal year 2011 and $7 trillion in cumulative deficits for the following decade.

"The United States faces daunting economic and budgetary challenges," Elmendorf told the committee, later adding, "To prevent debt from becoming unsupportable, policymakers will have to substantially restrain the growth of spending, raise revenues significantly above their historical share of GDP, or pursue some combination of those two approaches."

The CBO forecasts $2.2 trillion in federal revenues and $3.7 trillion in expenditures in 2011. Revenues are projected to rise to $5 trillion by 2021 and expenditures to increase to $5.7 trillion that year. This year, publicly-held debt – which does not include things like the Social Security Trust Fund, money that the government essentially owes itself – will total about $10.4 trillion. That figure is expected to rise to $18.2 trillion by 2021.

While the CBO projections show budget deficits generally declining significantly as a percentage of GDP during the next decade, they almost certainly greatly understate the shortfalls since they assume the continuation of current laws. The numbers, then, will only be accurate if lawmakers, among other things, do not extend any of the 2001 Bush tax cuts past 2012, do not continue to make adjustments to the alternative minimum tax to limit its reach and allow sharp reductions in Medicare payments to doctors to go into effect.

Elmendorf specifically noted the role of health care costs in driving government expenditures. When Sen. Rob Portman, R-Ohio, asked him to identify the single biggest fiscal challenge faced by the nation, he said that, "The part of the spending that is growing very rapidly, and much faster than GDP, is spending on the government's large health care programs, both because of the aging of the population … and because of rising health spending." This followed warnings about entitlement spending in his prepared testimony.

"Spending on the government's major mandatory health care programs – Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies to be provided through insurance exchanges – along with Social Security will increase from roughly 10 percent of GDP in 2011 to about 16 percent over the next 25 years," Elmendorf said. "If revenues stay close to their average share of GDP for the past 40 years, that rise in spending will lead to rapidly growing budget deficits and surging federal debt."

Spending on Social Security, Medicare and Medicaid are expected to total $1.5 trillion in 2011, 40 percent of federal expenditures and 67 percent of revenues.

CBO projected that the Medicare Hospital Insurance Trust Fund will pay out $40 billion this year and will be exhausted by 2021.

Resolution Would Oppose Bailouts of Public Pensions

A Utah lawmaker on Jan. 6 introduced a resolution opposing a federal bailout of public pension plans and supporting efforts to switch such pensions from defined benefit plans to defined contribution accounts.

The non-binding resolution from Rep. Jason Chaffetz, R-Utah, asserts that State and local pension plans have unfunded liabilities of "up to $3 trillion," that many plans have "understated liabilities and overstated asset growth rates and have employed methodologies that private sector plans are prohibited from using by Federal law," and that several plans "are expected to fully exhaust their funds within ten years."

The resolution would express as the sense of the House of Representatives that "the Federal Government should not bailout State and local government employee pension plans and other post-employment benefit plans; and State and local governments should immediately institute reforms to their employee pensions plans, including replacing defined benefit plans with defined contribution plans."

Chaffetz called the measure "a shot across the bow to States, saying you better step up and be self-sufficient."

"You can't rely on the federal government to bail you out of your woes," he said.

Chaffetz is supporting the Public Employee Pension Transparency Act from Rep. Devin Nunes, R-Calif., which would require public pensions to file annual reports with the U.S. treasury secretary that contain details about their assets, liabilities and funding status using a prescribed methodology and would threaten non-compliant States and localities with a denial of federal tax benefits for their bonds. The bill also would prohibit federal bailouts of State and local pension plans. Nunes introduced his bill in December, but it died when the last session of Congress adjourned. He has indicated that he will reintroduce it this year.

The Nunes legislation is strongly opposed by the public pension community, which generally regards it as part of an organized effort to reduce spending on public pensions and push for conversions to defined contribution plans. Several groups involved in public pensions, including the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement, have called the proposal "inappropriate" and "unwarranted" and said in December that it "represents a fundamental lack of understanding regarding the strong accounting rules and strict legal constraints already in place that require open and transparent governmental financial reporting and processes." The groups have also stressed that States and localities are not seeking federal bailouts.

SEC Adopts Say-on-Pay Rules

The Securities and Exchange Commission (SEC) on Jan. 25 adopted rules that will give shareholders the ability to cast advisory votes on executive compensation packages.

The regulations will require companies to:

- Hold advisory votes on executive compensation at least once every three years and advisory votes on the frequency with which shareholders want "say-on-pay" votes at least once every six years, effective for annual meetings taking place on or after Jan. 21, 2011.
- Provide additional disclosures related to "golden parachute" arrangements in merger transactions, and give shareholders an advisory vote on such arrangements, effective for filings on or after April 25, 2011.

Companies with market capitalizations of less than $75 million will not be bound by the say-on-pay vote and frequency vote requirements until January 2013.

The financial reform bill that became law last year directed the SEC to enact say-on-pay rules, a provision that CalPERS supported in several letters to Congress.

RELATED NATIONAL AND INDUSTRY NEWS

Employer Contributions to Public Pensions Fairly Steady for 15 years: NASRA

Less than 3 percent of all State and local government spending is used to fund public pensions, according to a study released on Jan. 18 by the National Association of State Retirement Administrators (NASRA).

While acknowledging that pension costs have risen since 2008, the study noted that employer contributions have remained fairly steady since the mid-1990s, "providing most employers with a fairly predictable expenditure for attaining retirement security." Recent contribution levels have ranged from a high of 3 percent of all State and local spending in 1995 and 1996 to a low of 1.9 percent in 2002, back up to 2.9 percent in 2008 and 2009.

In 2008, California tied with Virginia for the sixth-highest percentage at 3.83. Nevada was the highest at 5.44, North Carolina the lowest at 0.92.

The cost of public pensions has been much discussed in Washington, D.C., and many State capitals lately, as States and localities struggle with budget shortfalls that some blame, in part, on the cost of public employee retirement benefits.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

California Congressman Continues Stumping for Pension Bill

A California Republican who has proposed legislation that would require State and local pension plans to report funding information to the federal government says that public pension beneficiaries should support his bill.

The Public Employee Pension Transparency Act (H.R. 6484), introduced by Rep. Devin Nunes, R-Calif., in December, would require public pensions to file annual reports with the U.S. treasury secretary that contain details about their assets, liabilities and funding status using a prescribed methodology. Non-compliant States and localities would be denied federal tax benefits for their bonds. The bill also would prohibit federal bailouts of State and local pension plans.

"The people that should be demanding this the most are the public employees themselves," Nunes said on Dec. 31. "What they have been promised they may not receive."

Several groups involved in public pensions, including the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement, however, have called Nunes' proposal "inappropriate" and "unwarranted" and said in December that it "represents a fundamental lack of understanding regarding the strong accounting rules and strict legal constraints already in place that require open and transparent governmental financial reporting and processes."

"The organizations urge Congress to oppose the legislation because it conflicts with existing governmental accounting standards, increases State and local government costs and undermines investor confidence in the municipal bond market," the groups stated.

The supporting materials for the bill rely heavily on work by Joshua Rauh, an associate professor of finance at Northwestern University's Kellogg School of Management. Rauh released a study in May in which he concluded that either funding or benefit reforms will be needed to keep State pension plans from running out of money, and wrote that it is not unlikely that the federal government will have to bail out some funds.

NASRA in June found his analysis to be flawed, and the December joint statement reiterated many of the earlier objections, pointing out that the "Government Accountability Office has found that public pensions on the whole are financially secure and positioned to meet their long-term pension obligations." In addition, they stressed that, notwithstanding the specters raised by Nunes and his five co-sponsors – including incoming House Oversight and Government Reform Committee Chairman Darrell Issa, R-Calif. – States and localities are not seeking federal bailouts.

"Inaccurate and inflammatory descriptions of the state of public pensions and unnecessary calls for federal intervention are unwarranted and only serve to confuse the public and unduly alarm State and local government retirees," they stated. "Further, they distract attention from the real pension crisis that Congress should address, namely the vast majority of Americans who have insufficient savings or protections to meet their retirement needs."

Nunes said, though, that "Part of the problem that we have today … is we don't know what the truly unfunded liabilities are."

"We need to know exactly what the number is," he said. "We can't make decisions at any level of government if we don't know what the true undisclosed benefit is or liability is for these benefits."

Some observers see the legislation as the latest tactic being used certain conservative individuals and organizations to get States and localities out of the defined benefit pension business. Among the groups supporting it are Americans for Tax Reform – which is headed by Grover Norquist, a leading advocate of converting public employees to defined contribution plans – Americans for Prosperity, the American Conservative Union and the U.S. Chamber of Commerce.

Conservative columnist George Will, in a Dec. 26 column that referenced "the often-dreamy assumptions" behind public pension funding calculations, noted that, when the federal government imposed transparency rules on corporate pensions, it "gave the private sector an incentive to move to defined contributions from defined-benefit plans, which are now primarily luxuries enjoyed by public employees."

Although Nunes' bill died when the last session of Congress adjourned, he has said that he will reintroduce it this year.

Boxer Vows to Defend EPA Rules on Greenhouse Gas Emissions

A California senator in early January said that she will do everything possible to stop Republicans from undoing new EPA regulations regarding greenhouse gas emissions.

Environmental Protection Agency (EPA) rules that went into effect on Jan. 2 require States to review air pollution permits from power plants and other major pollution sources for compliance with the Clean Air Act. The agency's assertion of its authority to regulate greenhouse gas emissions is highly unpopular with many representatives of industry, who argue that it will slow the economy, and GOP lawmakers – along with some coal-belt Democrats – want to block the rules. House Energy and Commerce Committee Chairman Fred Upton, R-Mich., said on Jan. 2 that his panel was "going to have early, early hearings on this" and that opponents of tighter emission rules won't "let this administration regulate what they've been unable to legislate."

Sen. Barbara Boxer, D-Calif., however, said on Jan. 6 that she will "use every tool available to me ... to oppose any legislative effort that threatens the health or safety or well-being of the American people."

"That includes [Upton's] desire to stop the Environmental Protection Agency from carrying out its responsibilities under the Clean Air Act," she said. "Too much carbon pollution is a threat to society."

GOP lawmakers, in the opening days of the current session of Congress, introduced three bills that take different approaches to blocking or delaying the EPA rules. Also, Republicans eliminated the five-year-old Select Committee for Energy Independence and Global Warming.

Boxer in 2009 sponsored legislation that would establish a national cap on greenhouse gas emissions and create an exchange on which emissions allowances could be traded. She said she would introduce a similar cap-and-trade bill in this session of Congress if she thought it would pass, but, "We're not going to do it if we don't have the votes."

2 Calif. Reps. Lose Chairmanships as 112th Congress Convenes

The 112th Congress convened on Jan. 5, and with Republicans taking control of the House, committees in that chamber now have new leaders.

Of the four House committees with primary jurisdiction over issues of importance to CalPERS, two replaced chairmen from California, and a third replaced a lawmaker with whom the pension fund has worked on financial issues.

On the House Education and the Workforce Committee – formerly the House Education and Labor Committee – which oversees pension issues, Rep. John Kline, R-Minn., replaced Rep. George Miller, D-Calif., as chairman, while on the House Energy and Commerce Committee, which has jurisdiction over health care and climate change issues, Rep. Fred Upton, R-Mich., replaced Rep. Henry Waxman, D-Calif., as chairman.

Rep. Spencer Bachus, R-Ala., meanwhile, became the new chairman of the House Financial Services Committee, replacing Rep. Barney Frank, D-Mass., who has worked with CalPERS on several financial and investment matters.

On the House Ways and Means Committee, which oversees Social Security, government health care programs and all tax issues, Rep. Dave Camp, R-Mich., replaced Rep. Sander Levin, D-Mich., as chairman.